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SUBJECT: THE ECONOMY ONE MONTH AFTER PESO REVALUATION AND THE
ANNOUNCEMENT OF NEW ECONOMIC POLICY MEASURES

REF: A) SANTIAGO 7602; B) SANTIAGO 7616

1. SUMMARY. AUGUST 4 ANNOUNCEMENTS OF AN 8.9 PERCENT INCREASE IN THE CONSUMER PRICE INDEX (CPI) FOR JULY AND OF 1.5 PERCENT JUMP IN THE UNEMPLOYMENT RATE DURING THE SECOND QUARTER ARE BOUND TO HAVE A DAMPENING EFFECT ON RECENTLY GENERATED ENTHUSIASM ABOUT THE ECONOMIC OUTLOOK. DESPITE, OR PERHAPS BECAUSE OF, JULY'S DISAPPOINTING INFLATION FIGURE, THE GOC IS CURRENTLY GIVING TOP ECONOMIC PRIORITY TO SLOWING DOWN THE RATE OF PRICE LEVEL INCREASE. THE EXCHANGE RATE IS TO BE DEVALUED DURING THE COMING MONTH, ALBEIT AT A SLOWER PACE THAN PREVIOUSLY ANNOUNCED, AND OTHER STEPS HAVE BEEN TAKEN TO DISCOURAGE SHORT-TERM CAPITAL INFLOWS. IT IS YET TOO EARLY TO TELL HOW EFFECTIVE A PESO REVALUED IN REAL TERMS, AND SPECIAL CENTRAL BANK LINES OF CREDIT, WILL BE IN STIMULATING A HIGHER LEVEL OF INVESTMENT ACTIVITY. END SUMMARY.

2. THE GOC MUST REGARD THE AUGUST 4TH ANNOUNCEMENT OF AN 8.9 PERCENT RATE OF INFLATION FOR JULY AS A DISAPPOINTING REACTION OF PRICES TO THE JUNE 29 ANNOUNCEMENT OF A REVALUATION OF THE PESO BY 10 PERCENT. A SUBSEQUENT PRICE ROLLBACK FOR A NUMBER OF PRODUCTS AND AN ANNOUNCE-
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MENT OF A VOLUNTARY 60-DAY FREEZE ON MANUFACTURERS' SALES PRICES HAD

RAISED EXPECTATIONS OF A DRAMATIC DROP FROM JUNE'S 12.5 PERCENT RATE. GOC ECONOMIC SPOKESMEN HAD BEEN PRIVATELY TALKING ABOUT A 7-8 PERCENT RATE FOR JULY, AND SOME OBSERVERS WENT EVEN LOWER.

3. PRESS AND GOC ECONOMISTS ARE, TO BE SURE, EMPHASIZING THE FEW POSITIVE ACHIEVEMENTS OF THE ANTI-INFLATION PROGRAM. ALTHOUGH THE CPI TRIPLED (210.11 PERCENT) BETWEEN JULY 1975 AND JULY 1976, ITS INCREASE FROM JULY 1974 TO JULY 1975 HAD BEEN BY A FACTOR OF FIVE (412.52 PERCENT). IT IS PRESENTLY BEING SUGGESTED THAT THIS REPRESENTS AN APPROXIMATE HALVING OF THE RATE OF INFLATION. (THOSE MATHEMATICALLY INCLINED WILL OF COURSE RECOGNIZE THAT THE GOC'S ANTI-INFLATION PERFORMANCE FALLS CONSIDERABLY SHORT OF THIS CLAIM.) MOREOVER, AND PERHAPS MORE RELEVANT, THOUGH SOMETHING THE GOC WOULD RATHER FORGET, IS THE FAILURE OF THE INFLATION RATE TO DECLINE DURING THE FIRST SEVEN MONTHS OF 1976 FROM THE RATE FOR THE LAST HALF OF 1975. (REF B)

4. SINCE THE CIP FOR JULY MEASURES THE INCREASE IN AVERAGE MONTHLY PRICES FROM JUNE'S AVERAGE, THE GOC RIGHTLY ASSERTS THAT THE EFFECTIVENESS OF NEW ANTI-INFLATION MEASURES HAS NOT YET GOTTEN A FAIR TEST. THE JULY RATE WAS STRONGLY AFFECTED BY PRICE INCREASES IN JUNE WHICH TOOK PLACE BEFORE THE ANNOUNCEMENTS WERE MADE. AUGUST AND SEPTEMBER SHOULD GIVE BETTER INDICATIONS OF THE LONGER-TERM EFFECTS OF THESE MEASURES.

5. IN RESPONSE TO PRESSURES FROM THE CHILEAN MANUFACTURERS' ASSOCIATION (SOFOFA), WHICH HAD COMMITTED ITS MEMBERSHIP TO A 60-DAY PRICE FREEZE, THE CENTRAL BANK (CB) HAS STATED THAT THE POLICY OF DAILY ADJUSTMENTS IN STRICT ACCORDANCE WITH THE PREVIOUS MONTH'S RATE OF IN-

FLATION, ANNOUNCED BY FINMIN CAUAS ON JUNE 29 (REFTEL A), WILL NOT BE APPLIED AS RIGOROUSLY AS PROMISED. INSTEAD, SEASONAL PRICE INCREASES AND DECREASES WILL BE ELIMINATED FROM THE CPI, THUS TO DEVELOP A SEASONALLY ADJUSTED CPI FOR PURPOSES OF CALCULATING THE UPCOMING MONTH'S EXCHANGE RATE ADJUSTMENTS. THE CB INTERPRETS RECENT BEEF, POTATO, AND ONION PRICE RISES AS SEASONAL IN NATURE. BY ELIMINATING THOSE PRICE CHANGES FROM THE CPI (AND ASSUMING THE SAME RATE OF PRICE INCREASE FOR THESE PRODUCTS AS FOR THE AVERAGE OF ALL OTHER ITEMS IN THE INDEX), THE INFLATION RATE FOR JULY, INSTEAD OF 8.9 PERCENT, BECOMES 6.4 PERCENT FOR EXCHANGE RATE PURPOSES. IT

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IS BY THIS LESSER PERCENTAGE THAT THE PESO WILL BE DEVALUED IN DAILY INCREMENTS BETWEEN AUGUST 5 AND SEPTEMBER 4. AS EARLIER REPORTED, 13.21 PESOS TO THE DOLLAR ON AUGUST 4 WILL THUS BECOME 14.04 ON SEPTEMBER 4.

6. SOME LOCAL ECONOMIC COMMENTATORS, WHILE SEEING SOME THEORETICAL VALUE IN ALLOWING FOR SEASONAL FACTORS IN EXCHANGE RATE POLICY, SUGGEST THAT THIS ADDITIONAL CHANGE IN EXCHANGE RATE POLICY WILL UNDER-

MINE PUBLIC CONFIDENCE IN THE FIRMNESS OF GOC POLICIES. CAUAS, AFTER ALL, HAD TOLD HIS NATIONWIDE TELEVISION AUDIENCE ON JUNE 29 THAT THE CPI (AND NOT "TAMPERED WITH" CPI) WOULD BE THE BASIS FOR DETERMINING THE EXCHANGE RATE. IT MUST ALSO MAKE EXPORTERS WONDER WHE-

TER HIGHER COPPER PRICES AND A BOP SURPLUS HAVE NOT SHIFTED GOC INTEREST FROM EXPORT PROMOTION TO MORE IMMEDIATE ECONOMIC PROBLEMS. FINALLY, ONE HAS TO WONDER WHETHER GOC POLICYMAKERS WILL FIND FURTHER DEFECTS IN ITS EXCHANGE POLICY. FOR EXAMPLE, IS THE PRICE CHANGE FOR THE MONTH JUST PAST THE MOST APPROPRIATE BASIS FOR DETERMINING THE DEVALUATION FOR THE MONTH TO COME, OR SHOULD SUCH PEGGING ALSO TAKE INTO ACCOUNT PRICE MOVEMENTS OVER A LONGER PERIOD OF TIME, INCLUDING EXPECTED PRICE INCREASES?

7. IN AN EFFORT TO DISCOURAGE SHORT-TERM CAPITAL INFLOWS THE CENTRAL BANK RECENTLY LENGTHENED THE PERIOD FOR CAPITAL REMITTANCES FROM SIX MONTHS TO TWO YEARS. NOW THAT THE CB HAS ACCUMULATED MORE THAN \$300 MILLION IN RESERVES, THE GOC WOULD LIKE TO SEE A SMALLER INFLOW OF SHORT-TERM CAPITAL, OR PERHAPS EVEN REVERSE THE FLOW, IN ORDER TO EXERT TIGHTER CONTROL OVER THE MONEY SUPPLY.

8. THE NATIONAL STATISTICAL INSTITUTE'S (INE) SECOND QUARTER SURVEY OF EMPLOYMENT FOR SANTIAGO SHOWED A 1.5 PERCENT INCREASE IN UNEMPLOYMENT FROM THE FIRST QUARTER, FROM 17.6 TO 19.1 PERCENT. THIS IS SOMEWHAT SURPRISING AS WELL AS DISAPPOINTING SINCE THE U. OF CHILE'S SURVEY HAD REGISTERED A 1.8 PERCENT DECREASE FROM MARCH TO JUNE (19.8 TO 18 PERCENT). (NOTE: THE INE SURVEY IS AN AVERAGE FOR THE QUARTER, HENCE THE TWO ARE NOT DIRECTLY COMPARABLE). AS THE MINIMUM EMPLOYMENT PROGRAM WAS BEING EXPANDED AT THE SAME TIME, THESE SURVEYS SUGGEST THAT THE EMPLOYMENT SITUATION IN SANTIAGO HAS NOT IMPROVED IN RECENT MONTHS. INDEED, IT MAY HAVE WORSENER. THE FIRST COUNTRY-WIDE EMPLOYMENT SURVEY FOR THE PERIOD MAY-DECEMBER 1975 SHOWS LIMITED OFFICIAL USE

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AN UNEMPLOYMENT RATE OF 14.7 PERCENT. THIS IS SOMEWHAT LARGER THAN ESTIMATES CAUAS HAD GIVEN TO US IN EARLY 1976 (13 PERCENT). WE DOUBT THE EMPLOYMENT SITUATION OUTSIDE SANTIAGO HAS IMPROVED THIS YEAR.

9. IT IS STILL TOO EARLY TO SAY HOW MUCH AND HOW SOON PESO REVALUATION AND SPECIAL CB LINES OF CREDIT WILL SPUR INVESTMENT ACTIVITY. GOC POLICYMAKERS TALK PRIVATELY ABOUT A LIVELY INVESTOR INTEREST DEVELOPING AS A CONSEQUENCE OF THESE MEASURES. WE ARE LESS OPTIMISTIC,

AT LEAST ABOUT THE SHORT-TERM PROSPECTS.
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